FILE COPY

No. 220 Misc.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

THE CALIFORNIA COMPANY, a corporation, *Appellant*,

v.

STATE OF COLORADO, ROBERT A. TILLOTALD, As Director of Revenue of the State of Colorado, HOMER F. BEDFORD, As Treasurer of the State of Colorado, *Appellees*.

On Appeal From the Supreme Court of the State of Colorado

MOTION TO DISMISS

DUKE W. DUNBAR
Attorney General
State Capitol Building
Denver 2, Colorado

FRANK E. HICKEY
Deputy Attorney General
State Capitol Building
Denver 2, Colorado

FRED M. WILSON
Special Assistant to the Attorney General
834 Majestic Building
Denver 2, Colorado

CARL W. BERGEEN
215 C Street, N.W.
Washington, D.C.
Special Assistant to the Attorney General

Counsel for Appellees

June 7, 1960

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

TABLE OF CONTENTS

	Page
Motion to Dismiss	1
Questions Presented	2
Statement	2
Reasons for Dismissing the Appeal	5
I. The classification upon which the petroleum extraction tax is based is a reasonable one, and therefore valid	5
II. The tax upon the extraction of petroleum products does not violate the Commerce Clause of the United States Constitution	11
A. The tax is imposed upon a purely intrastate activity occurring in the State of Colorado, an activity which is not interstate commerce	11
B. The Colorado petroleum extraction tax does not constitute a substantial burden upon interstate commerce	11
Conclusion	14
Appendix A	1a

TABLE OF AUTHORITIES

CASES:

Champlin Refining Co. v. Corporation Commission, 286 U.S. 210 ..... 8, 12
Engel v. O'Malley, 219 U.S. 128 8
Great Atlantic & Pacific Tea Co. v. Grosjean, 301 U.S. 412 ..... 9, 10
Hope Natural Gas Co. v. Hall, 274 U.S. 284 12
Michigan-Wisconsin Pipeline Co. v. Calvert, 347 U.S. 157 11
Miller Bros. Co. v. Maryland, 347 U.S. 340 13
Nippert v. City of Richmond, 327 U.S. 416 13
Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 ..... 12, 13

	Page
Ohio Oil Co. v. Conway, 281 U.S. 146	6, 10
Oliver Mining Co. v. Lord, 262 U.S. 172	12
Pacific American Fisheries v. Territory of Alaska, 269 U.S. 269	10
Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672	11
Stewart Dry Goods Co. v. Lewis, 294 U.S. 550	6, 9, 10
Utah Power & Light Co. v. Pfost, 286 U.S. 165	12
Valentine v. Great Atlantic & Pacific Tea Co., 299 U.S. 32	6
Welch v. Henry, 305 U.S. 134	10
West Publishing Co. v. McColgan, 328 U.S. 823	13
STATUTES:	
Colorado Revised Statutes, 1953, Section 100-6-1, 5	7
Colorado Session Laws, 1953, Chapter 131; Colorado Revised Statutes, 1953, Section 138-1-7e	4

IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

No. 930

THE CALIFORNIA COMPANY, a corporation, *Appellant*,

v.

STATE OF COLORADO, ROBERT A. THEOBALD, As Director of Revenue of the State of Colorado, HOMER F. BEDFORD, As Treasurer of the State of Colorado, *Appellees*.

On Appeal From the Supreme Court of the State of Colorado

MOTION TO DISMISS

Pursuant to Rule 16, appellees move to dismiss the appeal from the final judgment of the Supreme Court of the State of Colorado, or, in the alternative, to affirm the judgment below, on the ground that the appeal presents no question sufficiently substantial to warrant further argument.

QUESTIONS PRESENTED

1. Whether, either the due process clause or the equal protection clause of the Fourteenth Amendment to the Constitution of the United States prevents the State of Colorado from imposing, at rates graduated in accordance with the entire amount realized from the sale or other disposition of petroleum products, a tax upon the production in the State of Colorado of oil and natural gas?

2. Whether, the imposition of such a tax upon all producers of oil and natural gas is invalid under the commerce clause of the Constitution of the United States, when the tax is imposed upon a producer who produces, processes, and sells the product within the State of Colorado to another person who immediately places the oil in interstate commerce?

STATEMENT

The California Company is a part of the corporate chain of Standard Oil Company of California. (*infra*, p. 4a)[1] It is the largest producer of oil at Rangely and in the entire State of Colorado. (*infra*, p. 1a) In the year 1953, the California Company produced approximately $26,000,000 of taxable petroleum products. (Appellant's Jurisdictional Statement, p. 9) almost all of which was crude oil sold in Colorado to others who ultimately disposed of it in interstate commerce.

The Colorado activities of the California Company are those of a producer only, and the company does not

[1] The findings of fact of the trial court are set forth as Appendix A to this motion to dismiss. References in this statement of facts are, except where otherwise noted, to the findings of fact made by the trial court and to Appendix A.

act as a marketer. (*infra*, p. 4a) It operates wells from which it extracts a mixture of oil and gas. (*infra*, p. 3a) From the well head, the mixture flows by pipe to a "separator", and most of the gas is removed. After the separator processes have been completed, the oil is piped to a "heater-treater", where the remainder of the natural gas is removed from the oil. Following this, the oil is piped to the lease tanks, in which it is temporarily stored and gauged or measured. (*infra*, p. 3a, Deft's Exhibit 14)

Connected to these lease tanks is a pipe line operated and owned by a common carrier, which carries the oil in interstate commerce for the purchasers, Standard Oil of California, Western States Refining Company, and Uinta Oil Refining Company. (*infra*, p. 4a) Until oil passes the outlet valves of California's lease tanks, it remains the property of that company, but at the instant which it leaves the lease tanks, it becomes the property of the buyer under the terms of a contract which provides (*infra*, p. 4a, Pltf's Exhibit 22)

> Crude oil sold under this agreement shall be delivered for Buyer's account to the pipelines connected to Seller's lease and fee storage tanks in the Rangely Field for interstate shipment. Title to crude oil thus delivered shall pass to Buyer when the oil passes the outlet valves of such storage tanks.

There is no market for the natural gas produced by the California Company in the Rangely Field. Consequently, except for a small amount of the natural gas used locally for heating purposes, and a somewhat larger portion used for re-injection, the gas is "flared", or burned in the open air. (*infra*, pp. 5a, 6a). The

record (R.T., p. 551)[2] shows, and the trial court found (*infra*, p. 6a) that this flaring not only results in a complete waste of the gas itself, but, according to the estimate of the company's own expert (R.T., p. 846), because of the loss of pressure, the total oil production of the Rangely Field by the California Company alone will be diminished by five hundred million dollars. The trial court also found that the amount of gas produced and flared increases progressively as the oil production increases. (*infra*, p. 7a, Deft's Exhibits 18 and 19) On the other hand, the trial court found that there is a direct relationship between gross production of oil from an established field and net profit. (*infra*, 7a, R.T., pp. 817, 818, 820, 821)

In 1953, the Colorado Legislature imposed a tax upon that portion of the gross income of every person derived from the production or extraction of crude oil or natural gas. The term "gross income" was defined as the entire amount realized from the sale or other disposition of all crude oil and natural gas produced or extracted during any taxable year from petroleum deposits located within Colorado. The tax rate is graduated, beginning at a rate of two percent on amounts less than $25,000, and increasing to a rate of five percent on amounts in excess of $300,000. The payment of certain ad valorem taxes is allowed as a direct credit against the tax imposed by this statute. Chapter 131, Colorado Session Laws, 1953; Colorado Revised Statutes, 1953 Section 138-1-7.

The California Company paid the tax imposed upon it by the statute under protest, and subsequently filed

[2] Citations to Reporter's Transcript are indicated by the initials R.T.

a claim for the refund of the tax. Its protest and claim for refund asserted that the statute is arbitrary and unreasonable in establishing an unreasonable classification and thus repugnant to the due process and equal protection clauses of Section 1 of the Fourteenth Amendment to the Constitution of the United States; and further, that the tax constitutes an unreasonable burden upon interstate commerce in violation of the interstate commerce provisions of Section 8, Article I, of the Constitution of the United States. (Appellant's Jurisdictional Statement, p. 9).

These objections to the validity of the tax were rejected by the State Department of Revenue, the trial court, and by the Supreme Court of Colorado. The appellant continues to assert them as the basis of its appeal to this Court.

REASONS FOR DISMISSING THE APPEAL

The appeal in this case should be dismissed, or in the alternative, the judgment of the Supreme Court of Colorado should be affirmed, because in the light of the decisions of this Court, the grounds advanced by the appellant for asserting that the statute is invalid are insubstantial.

I. THE CLASSIFICATION UPON WHICH THE PETROLEUM TAX ACT IS BASED IS A REASONABLE ONE, AND IS THEREFORE VALID

Appellant's first challenge to the tax is the assertion that the statute denies it the equal protection of the law. Appellant, however, makes no real effort to demonstrate that the statute is arbitrary or oppressive. On the contrary, the company contents itself with the

assertion that any graduated gross income tax is, in itself, an arbitrary discrimination.[3]

This assertion raises no substantial question. The fact that one taxpayer is treated differently from another, standing alone falls far short of establishing the arbitrary discrimination forbidden by the Fourteenth Amendment. The governing principle was stated by this Court in *Ohio Oil Company* v. *Conway*, 281 U.S. 146, 159:

> The States, in the exercise of their taxing power, as with respect to the exertion of other powers, are subject to the requirements of the due process and the equal protection clauses of the Fourteenth Amendment, but that Amendment imposes no iron rule of equality, prohibiting the flexibility and variety that are appropriate to schemes of taxation. The State may tax real and personal property in a different manner. It may grant exemp-

[3] In making this broad assertion, appellant relies exclusively upon the supposed authority of *Stewart Dry Goods Co.* v. *Lewis*, 294 U.S. 550, and *Valentine* v. *Great Atlantic & Pacific Tea Co.*, 299 U.S. 32, a decision which rested entirely upon the authority of the *Stewart* case. The *Stewart* case invalidated a graduated sales tax, because the Court felt that the result of such a tax, under the circumstances shown, was arbitrary. The tax was imposed upon all retailers, and took no account of the fact that margins of profit vary widely in the various retail enterprises. As an example of the arbitrary effect of the tax, the Court pointed to the fact that one of the challengers of the tax suffered a net loss, although its gross sales were more than eleven million dollars in one year. But there is nothing in the *Stewart* decision which supports the appellant's view that the fact that the tax is graduated, and that fact alone, invalidates a tax based upon a reasonable classification in which the volume of business is one of the factors reasonably distinguishing one class of taxpayers from another class. The Colorado tax is, as we demonstrate, based on a rational classification which fully justifies the graduation of the tax rates.

> tions. The State is not limited to ad valorem taxation. It may impose different specific taxes upon different trades and professions and may vary the rates of excise upon various products. In levying such taxes, the State is not required to resort to close distinctions or to maintain a precise, scientific uniformity with reference to composition, use, or value.

The tax which the appellant challenges in this case is a valid exercise of this power to make distinctions between classes of taxpayers. It rests upon two rational foundations derived from the expressed policy of Colorado.

The first, and perhaps the most important, basis of the classification represented by the graduation of the rates upon the extraction of petroleum products is the established and legislatively declared policy of Colorado to prevent the waste of oil and gas.[4] The amount of oil produced has a definite relationship to the waste of gas and the diminution of the ultimate recovery from the field. "It is true, no doubt, that where size is not an index to an admitted evil, the law cannot dis-

---

[4] Colorado Revised Statutes, 1953, 100-6-1; 5: "Section 1. The waste of oil and gas or either of them in the State of Colorado as in this Act defined is hereby prohibited.

* * * * * * * * * * *

"Section 5. The term 'waste' as applied to gas shall include the escape, blowing, or releasing, directly or indirectly, into the open air of gas from wells productive of gas only, or gas in an excessive or unreasonable amount from wells producing oil or both oil and gas; and the production of gas in quantities or in such manner as will unreasonably reduce reservoir pressure or unreasonably diminish the quantity of oil or gas that might ultimately be produced; excepting that gas that is reasonably necessary in the drilling, completing, testing, and in furnishing power for the production of wells."

criminate between the great and small. But in this case size is an index." *Engel* v. *O'Malley*, 219 U.S. 128, 138. Increasing production in the Rangely Field has led inevitably to such a waste of natural gas as the legislature attempted to prevent. In this case, the trial court found (*infra*, p. 6a)

> The gas has the necessary physical characteristics to permit its application to economic use, but a pipeline has never been built, and without a pipeline there is no available market for gas and it has no present economic value. Therefore, it is wasted by flaring.
>
> During 1953, hundreds of billions of cubic feet of this gas were flared and wasted by the California Company as a quick and easy way to dispose of the gas, and as a way to permit the company to produce and sell its oil.
>
> * * * * * * *
>
> Additionally, more rapid production of the oil results in progressively higher waste of gas. To illustrate, with small production, approximately 500 cu. ft. of gas is produced with each barrel of oil taken from the ground; but, with increased production (production which was reached by the California Company at Rangely in 1953) approximately 2,000 cu. ft. of gas is produced with each barrel of oil. Thus, since almost all of the gas is wasted, the increased production results in progressively increased economic waste.

That the State of Colorado may, agreeably with the provisions of the Constitution of the United States, prevent such waste of a valuable natural resource is not open to doubt. *Champlin Refining Co.* v. *Corporation Commission*, 286 U.S. 210, 233, 234. It is equally indisputable that taxation may be made the implement

of the exercise of the state's police power. *Great Atlantic & Pacific Tea Co.* v. *Grosjean*, 301 U.S. 412, 426.

A second rational basis for the graduation of the tax is the greater ability of the larger producers to pay the tax. The trial court found from the evidence (*infra*, p. 7a)

> At the same time, because of the peculiar nature of the petroleum industry, an increased rate of production typically results in an increased rate of net profit. In this connection, income derived from proven oil reserves, readily served by pipeline, is economically more akin to dividends received from stock or to interest received from bonds than it is to income derived from the unusual highly competitive retail business. Once a field is proven and transportation facilities are available, the nature of the business is such that the more oil which is produced and sold (limited, of course, by good production practices), the higher the rate of immediate net profit. The company's own expert admitted that this is typically true of the industry; and, certainly, the California Company made neither a contention nor a showing that it operated at a loss in Colorado during 1953, or, for that matter, during any other year.

Graduated rates of tax justified by a greater ability to pay are imposed by the Federal government and by the over-whelming majority of the states. It is much too late a day in constitutional history seriously to contend that a tax structure founded upon increasing rates of profit is an arbitrary classification.[5] In a

[5] The failure of the California Company to observe that the rationale of the *Stewart* decision is found in the fact that the taxpayer there demonstrated the lack of relationship between increasing volume of sales and net earnings. This undoubtedly explains appellant's complete and unfounded reliance on *Stewart*

variety of situations, this Court has approved graduation of tax rates based upon increasing values, and consequent greater ability to pay. In *Great Atlantic & Pacific Tea Co.* v. *Grosjean*, 301 U.S. 412, a progressively increasing tax rate upon store units under a common ownership was held valid because the Court found basis for it in the more favorable buying power, and consequent earnings of multiple stores. In *Ohio Oil Co.* v. *Conway*, 281 U.S. 146, the increasing value of petroleum of different grades was held to supply a rational foundation for graduated rates of tax based upon a gravity scale. In *Pacific American Fisheries* v. *Territory of Alaska*, 269 U.S. 269, the fact that a small pack may mean a loss and a larger one a profit was found to be an intelligible ground of policy justifying tax rates graduated in relation to the number of cases of salmon packed. In *Welch* v. *Henry*, 305 U.S. 134, graduated rates of tax imposed upon income from dividends were sustained.

These examples are sufficient to indicate that the graduation of tax rates does not deny equal protection if it rests upon intelligible bases of public policy. As we have demonstrated, the graduated rates imposed by the Colorado petroleum extraction tax have an intelligible and justifiable basis either in the public policy to discourage waste of a valuable natural resources or in the demonstrated correlation between greater profits and increasing production. The appellant's argument

---

Dry Goods Co. v. *Lewis*, 294 U.S. 550. In contrast, the present case is one in which the appellant failed to make any such showing. On the other hand, the State proved that there is a correlation between increasing production and greater net earnings. It follows that, as applied here, the *Stewart* case does not support the argument made by the appellant that ability to pay is not a proper basis of classification.

that the tax is arbitrary merely because the rates are graduated raises no substantial question which would justify this Court in interfering with the taxation and fiscal policies adopted by the Colorado legislature.

II. THE TAX UPON THE EXTRACTION OF PETROLEUM PRODUCTS DOES NOT VIOLATE THE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION

A. The Tax Is Imposed Upon a Purely Intrastate Activity Occurring in the State of Colorado, an Activity Which Is Not Interstate Commerce

The tax which the appellant challenges is undeniably placed upon an activity which begins and ends in Colorado. The California Company produces oil in Colorado from lands in Colorado; processes the oil in Colorado; stores and measures the oil in Colorado; and sells it in Colorado. That such activities are exclusively intrastate is not arguable. Appellant asserts[6] that the fact that its sales are made to persons who immediately place the oil in interstate commerce deprives Colorado of jurisdiction to tax the producing activities.

[6] Appellant relies primarily on *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, and *Michigan-Wisconsin Pipe Line Co.* v. *Calvert*, 347 U.S. 157, for support of its assertion that its activities constitute interstate commerce. Neither of these cases is relevant to the issue of the jurisdiction of Colorado to levy the tax. The *Phillips* case involved the duty of the Federal Power Commission to regulate the price paid by interstate pipelines for natural gas ultimately sold to consumers in other states. *Michigan-Wisconsin Pipeline Co.* v. *Calvert*, *supra*, involved a situation precisely the reverse of the situation created by the Colorado tax. In *Michigan-Wisconsin*, the tax was laid upon the purchaser, who was forbidden to pass it on to the producer. The tax was held invalid because it was not imposed until the product had entered interstate commerce. By contrast, the Colorado tax is imposed on the extraction of the oil, and before the sale by which the oil enters the flow of interstate commerce.

This Court has rejected an equivalent assertion too many times for appellant's proposition seriously to be argued now. See, *e.g.*, *Oliver Mining Co.* v. *Lord*, 262 U.S. 173, 178; *Hope Natural Gas Co.* v. *Hall*, 274 U.S. 284, 288; *Champlin Refining Co.* v. *Corporation Commission*, 286 U.S. 210, 235; Cf, *Utah Power & Light Co.* v. *Pfost*, 286 U.S. 165, 182. In *Oliver Mining Co.* v. *Lord*, *supra*, the Court, in flatly rejecting the argument advanced hereby appellant, said (262 U.S. at pp. 178, 179)

> . . . Mining is not interstate commerce, but like manufacturing, is a local business, subject to local regulation and taxation. . . . Its character in this regard is intrinsic, is not affected by the intended use or disposal of the product, is not controlled by contractual engagements, and persists even though the business be conducted in close connection with interstate commerce.
>
> * * * * * * *
>
> The ore does not enter interstate commerce until after the mining is done, and the tax is imposed only in respect of the mining. No discrimination against interstate commerce is involved. . . .

B. The Colorado Petroleum Extraction Tax Does Not Constitute a Substantial Burden Upon Interstate Commerce

Since the tax is imposed exclusively upon local activity within the State of Colorado, there is no arguable basis for asserting that it is a burden on interstate commerce. But even if the activity were wholly interstate commerce, Colorado could impose the tax, provided it required no more than that the California Company pay its fair share of the tax burden. *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 461, 462.

If the California Company means to assert that there is here lacking a sufficient local activity to forge a minimum connection (Cf, *Miller Bros. Co.* v. *Maryland*, 347 U.S. 340, 344, 345) to satisfy jurisdictional requirements for the imposition of the tax, its argument strains credulity. The Colorado tax is laid upon income producing activities all of which occur within the States. The extraction, gathering, measuring, and sale of the petroleum—if not in fact all of appellant's income producing activities—constitute a far larger proportion of income production than the maintenance of a sales office used only as a clearing house for orders (*Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 460) or the use of borrowed space for the storage of books (*West Publishing Co.* v. *McColgan*, 328 U.S. 823).

Can it be seriously argued that the Colorado tax is discriminatory or an unreasonable burden on interstate commerce? It does not, and does not purport to, exact a single penny's worth of tax for the privilege of engaging in interstate commerce within the State. It taxes the extraction of oil without regard to the sale of the product in interstate or intrastate commerce. In no way does it attempt to impede or suppress those selling in interstate commerce. Cf, *Nippert* v. *City of Richmond*, 327 U.S. 416. No local producer or seller or buyer receives any advantage over the California Company.

Any assertion that this tax is a discriminatory burden upon interstate commerce is simply not supported by the facts, and does not raise any substantial question.

CONCLUSION

As we have demonstrated, the tax challenged by the California Company rests upon rational considerations of policy which sustain any classification resulting from the graduation of the tax rates. The tax is imposed only upon activities undeniably local in nature. The appeal which here challenges the tax raises no substantial question, and should be dismissed.

Respectfully submitted,

DUKE W. DUNBAR
Attorney General
State Capitol Building
Denver 2, Colorado

FRANK E. HICKEY
Deputy Attorney General
State Capitol Building
Denver 2, Colorado

FRED M. WINNER
Special Assistant to the Attorney General
834 Majestic Building
Denver 2, Colorado

CARL W. BERUEFFY
215 C Street, N.W.
Washington, D.C.
Special Assistant to the Attorney General

Counsel for Appellees

June 7, 1960

APPENDIX

APPENDIX A

Findings of Fact by the Trial Court

(Introductory matters and conclusions of law are omitted.)

Upon these issues framed by the pleadings, several days' testimony was taken to establish the facts considered pertinent and material by the parties. There were some conflicts in the testimony, but, having observed the witnesses on the stand, the Court finds the following facts:

Colorado has not been blessed with numerous large oil fields, and the largest known field in this state is Rangely Field. The California Company is both the largest producer of oil at Rangely and the largest producer in the entire state. In addition to its production at Rangely, it has other Colorado production at the Wilson Creek and the Black Hollow Fields, but Rangely represents the greatest proportion of its activity and production. That being true, although the production and marketing procedures differ in unimportant detail at Rangely, Wilson Creek and Black Hollow, most of the testimony concerned Rangely, and the detail of the procedure at Rangely is set forth in this opinion. In all fields in Colorado in which the company has production it operates under conventional oil and gas leases. In some instances, private individuals are the lessors, and in others the leases have been granted by the United States, and it is the existence of these latter leases which has given rise to the contention of the company that the tax is unlawful as (in the language of the plaintiff's brief) "a tax upon property of the United States and an unlawful burden upon an instrumentality of the United States."

As a preface to a discussion of the constitutional arguments of the parties and to a consideration of some of the authorities cited in the briefs, it is appropriate to mention the geographic location of the fields. Rangely is located in the extreme western part of the state. It is

separated from the population and industrial centers of Colorado by the Continental Divide, and the nature of the terrain is such that the normal market for the oil produced from the field is across the Colorado-Utah line into Salt Lake City, rather than across the mountains into Denver. Wilson Creek is also located to the west of the Divide, and the natural market for its production is by pipeline into Wyoming where the Colorado oil mingles with Wyoming oil in the interstate pipelines serving the Wyoming fields. Black Hollow is east of the divide, and some of its oil is marketed intrastate while some is marketed interstate. Geographic features are such that it is almost inevitable that Rangely and Wilson Creek oil be transported across state lines for refining and for ultimate consumption and use. There appears to be no present probability that an intrastate pipeline will be built to refine either Rangely or Wilson Creek oil in the State of Colorado. The California Company urges that this is of importance, because one of its contentions is that "the oil is in interstate commerce from the time it leaves the bottom of the hole until it reaches the refinery at the end of the interstate pipeline."

Some oil which is produced in Colorado flows into Wyoming where it mingles with oil produced in Wyoming in its journey to refinery and to ultimate consumer. The Colorado oil is in free and open competition with Wyoming oil, and there was no showing that the tax in question hampers or in any way impedes the sale of Colorado oil. Wyoming has no "severance tax" or other special tax on the production of oil, and, if it be determined that the oil produced by the California Company is in interstate commerce when owned by that corporation, there is no evidence in the record showing that the tax constitutes an unreasonable burden on commerce as a factual matter. Accordingly, the Court specifically finds that the quantum of the tax represents only a fair share of the cost of state government, and that the tax does not interfere in any way with the sale of oil in interstate commerce, and that it

does not constitute an unreasonable burden on that commerce.

Returning, now, to a consideration of the history and production methods used at Rangely Field, it appears that the field was discovered and proven more than 10 years before its true development. Substantial production from the field did not commence until after the gasoline shortage resulting from World War II; and the development of the field has taken place for the most part since that time. During the long period of dormancy of the area, the California Company was the principal lessee, and it has been a moving factor in the development of the area into a major oil field.

The production and marketing procedure is substantially as follows:

Oil and gas reach the surface (referred to in the testimony as the "well head") as a homogeneous mass; and, of physical necessity, if oil is brought to the surface, gas is mixed with it. (However, as will be mentioned in more detail later herein, as the rate of production of oil increases, the rate of production of gas increases in more rapid progression.)

After the admixed oil and gas reach the well head, the mixture flows by pipe (owned by the California Company) to a "separator." The separator processes the mixture to remove most of the gas from the oil. The oil then flows by pipe (owned by the California Company) to a "heater-treater" where the remainder of the gas is removed from the oil. From the heater-treater, the oil is transported by pipe (owned by the California Company) to "lease tanks" (owned by the California Company) in which the oil is temporarily stored and is gauged or measured. To this point, the oil has not left the lease site or its immediate vicinity, and it is the sole property of the producer—the California Company.

The lease tanks are connected to an interstate pipeline operated as a common carrier, and, at the instant the oil leaves the lease tanks, it starts its journey in interstate commerce. The California Company does not own and it has no interest in the interstate pipeline. To the contrary, that pipeline is owned and operated by a separate corporation.

The California Company retains title to and retains all of the increments of ownership of the oil up to the point in the production process that the oil leaves the lease tanks, but, by contract, title and all increments of ownership pass to a purchaser at the instant the oil leaves the lease tanks and enters the interstate pipeline. The California Company itself sends no oil owned by it through the pipeline. Instead, all of the oil it produces in the State of Colorado is sold to other corporations—that is, to Standard Oil Company of California, Western States Refining Company and Uinta Oil Refining Company, all of which are corporations entirely separate and distinct from plaintiff and entirely separate and distinct from the pipeline company—and these sales are fully consummated when the oil leaves the lease tanks. At that instant, the purchaser's firm obligation to pay for the oil comes into being, and all risk of loss is on the purchaser.

The evidence shows that although the California Company is part of the corporate chain of Standard Oil Company of California, the California Company is a separate corporation; and, at least as to all oil it produces in Colorado, the company acts only as a producer and not as a marketing company. The total interest of the California Company in all oil it produces in Colorado ceases, after the oil has been produced and twice processed by the company, but long before the oil leaves the State of Colorado.

The gas produced by the California Company in Colorado never enters an interstate pipeline, and, by stipulation of the parties, it was agreed in the course of the trial that

there is no contention made that, as applied to gas, the statute in question imposes an unconstitutional burden on interstate commerce. Nevertheless, in connection with other issues involved in the case, and in connection with the consideration of some of the recent decisions of appellate courts, it is necessary that the disposition made of the gas be traced.

The gas resulting from the oil processing at both the separator and the heater-treater flows by pipe into the Rangely Gasoline Plant. This plant is owned by some, but not all, of the lessees at Rangely Field, and the California Company has been designated as its "operator" by contract among the several plant owners. The function of this plant is to extract or manufacture from the gas the finished products of butane, propane and natural gasoline, all of which are marketed without transportation in interstate pipeline.

The gas entering the plant from the separator and the heater-treater is commonly called "wet gas", and, after the finished products of butane, propane and natural gasoline are extracted or manufactured in the plant, the residue gas which results is commonly called "dry gas". The finished products are then sold, with the gasoline plant acting as sales agent for all owner-lessees and non-owner-lessees, and the sales price is distributed among owner-lessees and non-owner-lessees in accordance with contract formula. Except for a small amount of the dry gas sold in and about the Town of Rangely, the proceeds received from the sale of the finished products represent the entire cash income received by anyone for the gas.

After the wet gas has entered the plant, and after the finished products have been extracted from it, the dry gas is returned to the leases from which it was produced. There, a small amount of it is used for fuel and heating purposes on the lease sites; but the overwhelming percentage of it is "flared." Flaring consists simply of burn-

ing the gas to get rid of it, and it is done because there is no pipeline for gas leading from the field to a population center which could consume and make economic use of it. The gas has the necessary physical characteristics to permit its application to economic use, but a pipeline has never been built, and without a pipeline there is no available market for the gas and it has no present economic value. Therefore, it is wasted by flaring.

During 1953, hundreds of billions of cubic feet of this gas were flared and wasted by the California Company as a quick and easy way to dispose of the gas, and as a way to permit the company to produce and sell its oil. Some of this gas could have been reinjected into the structure; and, according to the opinion of the California Company experts, reinjection would save some of the gas and would increase the life and the total production to be expected from the field. In fairness to the California Company, it now is and at all times has been a vigorous advocate for a conservation program which would require the reinjection of some of the gas. However, other interests in the field opposed reinjection, and the Colorado Oil and Gas Commission was unable to demand reinjection over the opposition of other lessees. Since it is not feasible for one lessee to reinject his or its gas into the structure if other lessees refuse to follow suit, the California Company was unable to carry out a satisfactory conservation and reinjection program during 1953.

However, even if gas were reinjected into the structure to the maximum amount urged by the California Company, many, many billions of cubic feet of gas would be flared and wasted by the California Company annually at Rangely Field. Thus, reinjection would reduce, but it would not eliminate the great economic waste resulting from flaring. The only way that this waste can be eliminated is to permit the oil to remain in the ground until there is an available pipeline from Rangely to some area which has a need for the gas.

Additionally, more rapid production of the oil results in progressively higher waste of the gas. To illustrate, with small production approximately 500 cu. ft. of gas is produced with each barrel of oil taken from the ground; but, with increased production (production which was reached by the California Company at Rangely in 1953) approximately 2,000 cu. ft. of gas is produced with each barrel of oil. Thus, since almost all of the gas is wasted, the increased production results in progressively increased economic waste.

At the same time, because of the peculiar nature of the petroleum industry, an increased rate of oil production typically results in an increased rate of net profit. In this connection, income derived from proven oil reserves, readily served by pipeline, is economically more akin to dividends received from stock or to interest received from bonds that it is to income derived from the usual highly competitive retail business. Once a field is proven and transportation facilities are available, the nature of the business is such that the more oil which is produced and sold (limited, of course, by good production practices), the higher the rate of immediate net profit. The company's own expert admitted that this is typically true of the industry; and, certainly, the California Company made neither a contention nor a showing that it operated at a loss in Colorado during 1953, or, for that matter, during any other year. In fact, the evidence showed that in both 1953 and 1954 (the only two years as to which evidence was offered as to company profits) the company made more than $1 million in net profit from its Colorado operations, after taking full allowance for the 27½% depletion which is allowed.

Any consideration of the multiple problems presented in this case must be grounded upon the recognition of the fundamental proposition that oil and gas constitute two of the great and critical natural resources of the nation.

The people of this state have since the inception of our government expressed the desire that the state exercise reasonable supervisory control over the state's resources; in fact, Article XVI of the Constitution of Colorado is devoted in its entirety to provisions concerning mining and water. Surely, then, as a factual matter, it is difficult to see how it can be contended that the imposition of a tax on the income derived from the production of oil in this state represents an unreasonable classification by the legislature. The facts conclusively show, and the Court finds as a fact that the classification is reasonable.

Before discussing the constitutional questions urged, brief mention must be made of some of the accounting and business procedures adopted by the California Company in preparing its income tax return. It will be recalled that in defining the phrase "gross income derived from the production or extraction of crude oil, natural gas, or both crude oil and natural gas from petroleum deposits located within this state," the legislature said that the phrase means:

> "the entire amount realized from the sale or other disposition of all crude oil and natural gas produced or extracted *during any taxable year* from petroleum deposits located within this state."

In preparing its return, the company made customary inventory adjustments, but, at time of trial, in some of the exhibits introduced by the company, and in the testimony of one of its principal accountancy witnesses, the company took the position that the production and sale both had to occur during a single tax year before any tax was due. It said at time of trial that if production was in one year and if sale was in the following year, the company would not owe any tax in either year. The accountant witness testified (Reporter's transcript, p. 233):

"Q. So that the net result of this report is that you show on Exhibit DD the proceeds received only from oil produced and disposed of during the period?

"A. That is correct, sir.

"Q. You exclude from this report the proceeds received from oil in inventory at the beginning of the period?

"A. That is correct, sir.

"Q. And you exclude from this report oil on hand at the end of the period?

"A. That is correct, sir."

Thus, it is the company's position that oil in inventory at year end is not taxable in either year, and, carried to its logical absurdity, that position would require the conclusion that if an entire year's production were stored, and if none of the oil produced from a given lease were sold until after the start of the next tax year, no tax would ever be due under the statute. Yet, at the same time that the company is pulling out of its sales the oil on hand at the beginning of a tax year, and at the same time it is not taking into account the oil on hand at the end of a tax year, it is vehemently arguing that the oil is in a continuous flow of interstate commerce from the time it "leaves the bottom of the hole." In the company's eyes, the oil is moving in commerce when its movement serves the company's desires, but it is stalled in inventory when the inactivity helps the then argument of the plaintiff.

Another unusual accounting procedure was shown during the course of the trial. In keeping its books and in preparing its tax returns, the company "assigned" a value to the dry gas used for heat and fuel. The monetary amount of this assigned value was $122,798.36 for the year 1953—the amount allowed as a refund by the Director of Revenue on the California Company's claim that this was gas used on the premises. No one paid anyone $122,798.36 or any other amount for this gas. The basis for assigning this

value was not clearly explained in the testimony, except that there was evidence that it was fixed by "the marketing department"; and, apparently, the value per thousand cubic feet of gas was arrived at by assigning to this gas for which there was no market the same price paid for gas in a Texas field where there was a pipeline and market for gas. The dollar value assigned to the gas at Rangely could not be correlated with the price paid for the trivial amount of gas sold in and about the Town of Rangely, although that gas was actually the only gas for which a cash consideration was paid by anyone.

The value thus assigned to the dry gas used for heat and fuel at Rangely was then included in gross income on the company's books and on its tax returns. Then, the company took advantage of its 27½% depletion allowance on its actual gross sales increased by the theoretical sale to itself at its self-assigned value for this dry gas. Thereafter, the company claimed this same self-assigned value as an operating expense (after depletion) and it filed its claim for refund with the Director of Revenue, claiming credit for this self-assigned dollar amount on its gross income tax return.